

## **Managerial Remuneration: Statutory Framework, Interpretational Challenges and Governance Considerations Regulatory Context and Contemporary Relevance**

In a recent knowledge-sharing webinar organised by **Mehta & Mehta**, professionals discussed the evolving regulatory framework governing managerial remuneration under the Companies Act, 2013. The discussion primarily focused on **Sections 196, 197, 198 and Schedule V** of the Act, along with practical issues frequently encountered by companies while structuring remuneration for directors and key managerial personnel.

Managerial remuneration continues to be one of the most scrutinised aspects of corporate governance, particularly in public companies and listed entities. While the law prescribes ceilings and approval requirements, several interpretational questions arise in practice, including the applicability of limits where directors are not formally designated as Managing Director or Whole-time Director, and the calculation of profits for remuneration purposes.

The session highlighted that many compliance challenges arise not from deliberate violations but from ambiguity in interpretation and inadequate understanding of the interplay between statutory provisions.

### **Legislative Framework and Policy Objective**

The regulation of managerial remuneration aims to strike a balance between **corporate autonomy in compensating managerial talent** and **protection of shareholder interests**.

Under the Companies Act, 1956, remuneration limits were stringent and closely monitored. The Companies Act, 2013 retained the regulatory oversight but introduced **greater flexibility**, particularly through the liberalisation of **Schedule V**, allowing companies to pay remuneration even in cases of inadequate or no profits subject to prescribed conditions.

The underlying legislative objective is to ensure:

- ⇒ Transparency in managerial compensation
- ⇒ Accountability of the Board and shareholders
- ⇒ Prevention of excessive managerial payouts
- ⇒ Alignment of remuneration with corporate performance

### **Managerial Personnel under the Act: Understanding the Key Positions**

The Companies Act recognises three principal managerial positions for remuneration regulation:

- ⇒ Managing Director (MD)
- ⇒ Whole-time Director (WTD)
- ⇒ Manager

A **Managing Director** is a director entrusted with substantial powers of management under the Articles, agreement, or Board resolution.

A **Whole-time Director** is a director in full-time employment of the company.

A **Manager**, as defined under the Act, is an individual who manages the whole or substantially the whole of the affairs of the company subject to the superintendence, control, and direction of the Board.

Although these positions differ in legal structure, the Act regulates remuneration for all managerial personnel through a unified statutory framework.

### **Section 197: Limits on Managerial Remuneration**

Section 197 prescribes the **overall ceiling on managerial remuneration in public companies**.

The total managerial remuneration payable by a public company to its directors, including Managing Director and Whole-time Director, shall not exceed:

11% of the net profits of the company for that financial year.

This limit is calculated in accordance with Section 198, which prescribes the method for computing net profits.

Within this overall ceiling, sub-limits apply:

- ⇒ 5% of net profits to any one Managing Director or Whole-time Director.
- ⇒ 10% collectively if there are more than one such directors.
- ⇒ 1% of net profits to non-executive directors if there is a Managing Director or Whole-time Director.
- ⇒ 3% if there is no Managing Director or Whole-time Director.

These limits reflect the principle that managerial compensation must remain proportionate to the company's financial performance.

### **Applicability to Directors Not Designated as MD or WTD**

A practical issue frequently raised in corporate practice is whether the remuneration limits under Section 197 apply where a director is not formally designated as Managing Director or Whole-time Director but performs executive functions.

The discussion highlighted that designation alone is not determinative. Where a director performs executive functions and receives remuneration in that capacity, regulatory authorities may examine the substance of the arrangement.

For public companies, remuneration paid to such executive directors may still fall within the ambit of Section 197, even if the formal designation of Managing Director or Whole-time Director is absent.

Therefore, companies must exercise caution when structuring executive roles without formal titles.

### **Section 198: Computation of Net Profits**

Section 198 provides the methodology for calculating net profits for the purpose of managerial remuneration.

Unlike accounting profit, this computation involves specific inclusions and exclusions.

Certain items must be credited, including:

- ⇒ Bounties and subsidies received from government authorities.

At the same time, specific items must be excluded, such as:

- ⇒ Capital profits arising from the sale of fixed assets
- ⇒ Profits from the issue of shares or debentures
- ⇒ Unrealised gains

Similarly, certain expenses must be deducted, including:

- ⇒ Usual working charges
- ⇒ Director remuneration
- ⇒ Depreciation as per statutory provisions

However, certain items are not permitted to be deducted, such as:

- ⇒ Income tax payable by the company
- ⇒ Voluntary compensation or damages not arising from contractual obligations

The objective of Section 198 is to ensure that managerial remuneration is linked to operational profitability rather than exceptional or capital gains.

### **Remuneration in Case of Inadequate or No Profits**

In situations where a company has no profits or inadequate profits, remuneration may still be paid in accordance with Schedule V of the Act.

Schedule V prescribes limits based on the effective capital of the company, along with conditions such as:

- ⇒ Approval by the Board of Directors
- ⇒ Approval by the Nomination and Remuneration Committee (where applicable)
- ⇒ Approval by shareholders through a special resolution

The provisions enable companies to compensate managerial personnel while maintaining governance safeguards.

### **Private Companies and Regulatory Exemptions**

One of the major interpretational issues discussed in practice relates to private companies. The notification dated 5 June 2015 granted certain exemptions to private companies, including relaxation from specific provisions of Section 196 relating to approval of terms and conditions of managerial appointment.

This has led to differing interpretations on whether remuneration limits under Section 197 apply in the same manner to private companies.

In practice, many professionals take the view that private companies enjoy greater flexibility in determining managerial remuneration, provided that the Articles of Association and shareholder approvals support the arrangement.

Nevertheless, governance considerations and stakeholder expectations often require companies to adopt prudent remuneration policies even where statutory limits are relaxed.

### **Governance Role of the Board and Nomination & Remuneration Committee**

The determination of managerial remuneration is not merely a compliance exercise but an important governance responsibility.

The Board of Directors is responsible for ensuring that remuneration structures are aligned with:

- ⇒ Corporate performance
- ⇒ Industry benchmarks
- ⇒ Shareholder expectations

For listed entities, the Nomination and Remuneration Committee (NRC) plays a central role in recommending remuneration policies, ensuring transparency and fairness in compensation structures.

Robust governance frameworks reduce the risk of disputes, regulatory scrutiny, and shareholder dissatisfaction.

### **Recurring Practical Challenges**

The webinar discussion highlighted several practical challenges frequently encountered in corporate practice:

- ⇒ Ambiguity in the applicability of Section 197 to executive directors without formal designation
- ⇒ Confusion regarding exemptions available to private companies
- ⇒ Incorrect computation of net profits under Section 198
- ⇒ Lack of clarity in structuring commission payments to directors
- ⇒ Inadequate documentation supporting remuneration decisions.

Many of these issues arise due to incomplete understanding of the statutory framework rather than deliberate non-compliance.

### **Governance Responsibility and Professional Vigilance**

Company Secretaries and compliance professionals play a critical role in ensuring adherence to the managerial remuneration framework.

Their responsibilities include:

- ⇒ Interpreting statutory provisions correctly
- ⇒ Advising the Board on permissible remuneration structures
- ⇒ Ensuring compliance with approval requirements
- ⇒ Verifying computation of net profits under Section 198
- ⇒ Maintaining proper documentation and disclosures

Given the increasing regulatory scrutiny on executive compensation, professional diligence becomes essential.

### **Conclusion**

The regulatory framework governing managerial remuneration under the Companies Act, 2013 represents a carefully designed balance between corporate flexibility and shareholder protection.

Sections 196, 197 and 198, read with Schedule V, provide the legal structure for determining remuneration while ensuring transparency and accountability.

As highlighted in the webinar discussion, effective compliance requires:

- ⇒ Clear understanding of statutory limits
- ⇒ Accurate computation of net profits
- ⇒ Proper structuring of executive roles
- ⇒ Strong governance oversight by the Board

Managerial remuneration is ultimately not just a legal compliance requirement but a key element of responsible corporate governance in the modern regulatory environment.

To stay informed or access the webinar recording, visit the YouTube channel:

 **"Decoding Corporate Laws with Mehta & Mehta"**